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DEPT FOR AF/SPG, A/S FRAZER, SE WILLIAMSON, AND EEB/IFD
NSC FOR BPITTMAN AND CHUDSON
DEPT PLS PASS USAID FOR AFR/SUDAN
DEPT PLS PASS TREASURY FOR OIA, USED WORLD BANK, AND USED IMF
ADDIS ABABA ALSO FOR USAU

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SUBJECT: PESSIMISTIC WORLD BANK COUNTRY MANAGER REVIEWS SUDAN'S
ECONOMIC OUTLOOK

REF: KHARTOUM 1220

11. (SBU) SUMMARY: Outgoing World Bank Country Manager Asif Faiz worries that Khartoum is not thinking through the potential economic fallout in crafting its strategy to counter a possible ICC indictment of President al-Bashir. Nor is the Government of South Sudan (GoSS) in Juba focusing on the economic requirements of independence. He expects the GoS to try to walk-back its Abyei-Roadmap revenue sharing commitments, leading to another flare-up in coming months. According to Faiz, agricultural development could help Sudan realize its enormous potential, but the sector remains plagued by poor planning and mismanagement. Bank-GoS relations have become so strained that the Bank may downgrade its presence in Khartoum when Faiz departs in October. End Summary.

INFLATION, FOREIGN EXCHANGE, AND THE FISCAL DEFICIT

12. (SBU) On August 19, soon-to-depart World Bank Country Manager Asif Faiz provided econoffs with a gloomy take on Sudan's political-economic prospects. According to Faiz, the salient macroeconomic problem now is accelerating inflation (reftel). Although the official inflation rate for the last 12 months was 8%, Faiz estimates that the actual rate was probably around 20%. Inflation in south Sudan, he said, is even higher. He stated that inflation is propelled primarily by shortages in the construction and services sectors, especially in the bustling Khartoum region, though international pricing pressure also plays a role. Food-price increases are not an underlying factor, but Faiz said that a bad harvest would be "a disaster," because global supplies of grain are so tight that Sudan would not be able to purchase what it would need on the world market.

13. (SBU) Faiz assessed Sudan's foreign-exchange reserves as strong. He noted that while the Bank of Sudan is maintaining significant dollar reserves, it is shifting more and more of its transactions into other currencies.

14. (SBU) Faiz explained Sudan's high fiscal deficit (4% of GDP, according to the March 2008 World Bank Interim Strategy Note), as the result of poor management of Sudan's volatile oil revenues and government expenditures. Faced with a cash shortage, the Finance Ministry sought to pay for immediate government purchases with bonds, resulting in a steep build-up of domestic debt. Faiz described Dr. Awad Ahmed Aljaz as "horrified" when he took over as Finance Minister in February. According to Asif, Aljaz replaced many of the senior Finance-Ministry staff and ordered that outstanding bonds be paid off as soon as possible. The fiscal deficit now is being brought back to a reasonable level. Faiz praised Aljaz as an effective manager and strong believer in fiscal discipline.

15. (SBU) Faiz professed to be extremely worried about the potential political and economic implications of a potential International Criminal Court (ICC) indictment of President Omar al-Bashir on charges of genocide. He said neither the Government of National Unity (GNU) in Khartoum nor the GoSS in Juba are trying to think through and prepare for the consequences of such an indictment. Faiz wonders whether signatories of the Rome Convention would maintain relations with a country whose president is under ICC indictment. Would they be able to continue to provide support to the various peace agreements? Would the GNU abrogate those agreements? Would the Bank and Fund have to break-off relations with Sudan? He noted that the GNU had just vetoed compromise proposals from both France and the Arab League. Khartoum is not considering the economic/financial repercussions that may stem from such hard-line tactics.

GOSS VULNERABLE TO 'FINANCIAL STRANGULATION'

16. (SBU) Likewise, Faiz expressed alarm that the GOSS is woefully unprepared for the financial and economic responsibilities of potential post-2011 independence (or even sooner, if the fallout from an ICC indictment sufficiently strains national unity). He lamented the shortsightedness of GOSS officials in not planning for an independent financial system. "If one assumes the worst, the South could be subject to an economic strangulation" by the North given its current lack of preparedness. While Faiz is confident political and military assistance to the South would be forthcoming from international donors, he doubted that they are thinking about

KHARTOUM 00001291 002 OF 003

economic and financial issues. He urged the USG to use its influence to focus the South on issues such as developing a relationship with the Federal Reserve.

17. (SBU) As have others, Asif was dismissive of the Bank of Southern Sudan (BoSS) Governor, although he said the Bank staff has "many good people." In contrast to the BoSS, he stated that the Bank of Sudan is in the extremely capable hands of Governor Dr. Sabir Mohamed Hassan. Hassan (a long-time IMF staffer) is honest and "has abided by both the letter and the spirit of the CPA," stated Faiz. "That's not something I can say about anyone else."

WEALTH SHARING AND GOVERNANCE IN ABYEI

18. (SBU) Extrapolating from recent production and revenue data, Faiz estimates that the 8% of Abyei's net oil revenues designated to Abyei's people and administration by the revenue-sharing provisions of the CPA amount to roughly \$50 million per year. In addition, he estimates that resources committed to the so called "Unity Fund" established in the Abyei Roadmap (50% of the GNU's share and 25% of the GoSS share of Abyei oil revenues) would amount to over \$200 million per year. "That's enough money to rebuild Abyei several times over," he said.

19. (SBU) Faiz believes that the GNU and GoSS will fail to meet their revenue-sharing commitments, however. He worries that the donors then will fall into the trap of trying to pick up the financial responsibility for Abyei's recovery and reconstruction. He urged donors to learn from past experience, ("I've seen this happen three times before," he commented) and carefully calibrate their response relative to GOS/GOSS commitments. Otherwise, he said, donors will be held responsible for government functions, and blamed when the population's expectations are not met. The success of UN and donor-supported programs will depend to a large extent on Abyei Administration ownership of decision-making and program implementation. He proposed a coordination and monitoring committee comprised of the Abyei Administration, UN, donors, GOS, and GOSS, possibly under to auspices of the AEC, to ensure that the GOS and GOSS are fulfilling their financial obligations.

AGRICULTURAL INVESTMENT BOOMING ...

¶10. (SBU) Faiz estimated that investment in agriculture (primarily from Gulf-Arab states) approached \$2 billion in the past year, reflected in the expansion of large mechanized farms of the Nile Valley, stretching from Kosti north to Dongola. When the Merowe dam starts generating electricity, he said, it will connect with the Egyptian grid and agricultural development will spread to the border at Wadi Haifa. Connection to the Ethiopian grid will move activity up the Blue Nile as well. Faiz compared Sudan's experience to that of Brazil, which a quarter century ago made a similar push towards large mechanized farming. It's no coincidence Brazil has recently opened an Embassy in Khartoum, he observed.

... BUT PRODUCTIVITY HOBBOLED BY POLICIES

¶11. (SBU) However, he continued, Sudan's potentially wealthy agriculture sector is hobbled by poor management and resource use. He cited distortions due to subsidies, taxes, lack of credit, lack of research and development, and even labor shortages as constraints on productivity. He lamented what he said was massive waste of water. To date, he said, production has been increased only by expanding acreage, but it could be increased three-four fold simply with better management. That agricultural planning is heavily centralized at the Agriculture Ministry remains problematic, due its lack of capacity and organization. By contrast, he said, the state-level agricultural boards are much more progressive.

WORLD BANK-GNU RELATIONSHIP DETERIORIATING

¶12. (SBU) Faiz lamented the World Bank's "difficult" relationship with the GoS. According to Faiz, the GoS's attitude toward the Bank deteriorated as it became clear that signing the CPA would not lead to a debt-relief package. The GoS has given up and "turned their backs on the West," he said, and has turned instead to China, India and Malaysia. The GoS is dissatisfied with these relationships, he said, and it bothers them quite a bit that they have been left behind (in their view) by the West. As a result of this frosty relationship, not to mention the possible ICC indictment of President Bashir, the Bank is unclear what its future role will be

KHARTOUM 00001291 003 OF 003

in Sudan.

Comment

¶13. (SBU) Faiz was notably more pessimistic than when we last met with him in March. Six months ago, he was relatively upbeat about Sudan's immediate prospects, although more cautious about longer-term challenges. He now is clearly worried about Sudan's deteriorating relations with the West in the wake of ICC prosecutor Ocampo's charges. He believes that the GNU is not considering the possible economic implications of a hard-line response to the ICC. He thinks the GoSS is at least as complacent regarding the fallout from the ICC, as well as the preparations required should it vote for independence in 2011. Faiz appears to be leaving Sudan disappointed that he has been unable to make a bigger difference, and his pessimistic outlook may reflect that disappointment, but his sense of gloom over the ICC process and its effect on the Sudanese political process is shared by many here in Sudan.

ASQUINO